INDO RAMA
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Q1 FY 2009 Investors / Analysts Conference Call Transcript

Moderator: Ladies and gentlemen, good afternoon and welcome to the Indo Rama Synthetics Limited Q1FY09 earnings concall. As a reminder for the duration of this presentation all participants' lines are in the listen-only mode. And there will be an opportunity for you to ask questions at the end of today's presentation. Should anyone need assistance during this conference call they may signal an operator by pressing * and then 0 on their touch tone phone.

Please note that this conference is being recorded. I would now like to hand the Conference over to Mr. Gavin Desa of Citigate Dewe Rogerson. Thank you and over to you Mr. Gavin Desa.

Gavin Desa: Thank you and welcome to the Indo Rama Synthetics Q1FY09 analyst and investor conference call. We have with us Mr. Vivek Kaul, President Finance, Indo Rama Synthetics & Mr. R. Gurumoorthy, Head Corp. Affairs. You may want to keep in mind that certain statements made in this call may be forward looking and a disclaimer to this affect has been included in the investor release, which was sent earlier. We will now begin this call with an overview of the operating and financial performance of the Company during the Quarter, which will be given to us by Mr. Vivek Kaul. I will now hand the floor over to Mr. Kaul after which we will have a question and answer session.

Vivek Kaul: Thank you Gavin and good afternoon to everybody. I welcome you to the first quarter conference call. Let me take this opportunity to cover some key developments and financial highlights for the period under review. Thereafter we will be happy to have an interactive forum where we can discuss questions that you may have in more detail. This Quarter has been particularly fruitful due to a healthy demand for our Polyester products and substantial contribution from our Power division. Increased demand meant that we could raise finished good prices helping to mitigate high prices of inputs namely PTA and MEG. It is expected that input prices will continue to rise in the foreseeable future however the availabilities of both PTA and MEG is expected to improve with a setting up of new capacities in the world. In sales terms there was a marked increase in the sale of PSF. In value terms both PSF and PFY as well as the Power division demonstrated improvement.

Sales of Power business have actually improved by almost 300%. The power division contributed significantly to revenues and gave us several advantages including access to cheaper power. Excess power was sold to the Maharashtra GRID thus improving profitability. Total sales during the Quarter of 118,466 MT are up slightly from 112,476 MT in the corresponding Quarter of last year. Sales of PFY have increased nominally by 3%, PSF by 14%, and Power division sales stood at Rs. 31.6 crore. Net sales increased by 15% to Rs. 790 crore EBITDA was Rs. 58.7 crore up 125% and cash profit increase by about 400% to Rs. 34.4 crore from Rs. 6.9 crore. These figures exclude exceptional items including notional and non cash loss in the foreign exchange market that resulted from sharp dollar appreciation. For the Quarter, our interest and the depreciation cost increased slightly to Rs. 24 crore and 37 crore, total debt stood at Rs. 1,019 million as on June 30th compared to Rs. 865 million as on June 30th of last year. We continued to see a healthy and positive demand which is further enhanced by continuingly firm cotton prices. This brings me to end of my discussion and we would now be happy to discuss any specific details or questions that you may have. Thank you.

Moderator: Thank you very much sir. Ladies and gentlemen we will now begin the question and answer session. Anyone who wishes to ask a question at this time may press * and 1 on their phone. The first question is from the line of Mr. Ricky Kripalani, a Private Investor. Please go ahead.

Ricky Kripalani: I wanted to check as to what capacity the industry is running currently?

Vivek Kaul: The industry is running at fairly low capacity currently. Lots of units have shut down production for this month, which includes Indo Rama and Bombay Dyeing and lots of POY manufacturers have also cut down production and the reason basically is that there has been a sharp down turn in the raw material prices with the crude cooling off from about USD143 - 144 per barrel to USD122 to USD125. The entire chain has seen sharp decline. In PX about USD400 has been shed in PTA about a USD100 has been shed and in MEG about USD150 has been shed. So given this fact in local market the PTA and MEG is still available at somewhat higher prices because they work on a trailing month average prices. So to avoid purchasing excessive PTA and MEG based on the formula pricing, all over the industry has decided to curtail production and start buying when PTA and MEG is available at reduced prices. Reduce existing stocks, so there is no loss in terms of sales but there is a cut down in production and most likely the industries' stocks will head very close to zero in the next three weeks.

Ricky Kripalani: But what about demand? Has the demand profile remained consistent or improved or is it under pressure too - for your finished products?

Vivek Kaul: Demand in the last fifteen days is seeing the pressure. Also it has been curtailed because the market is expecting, a sharp correction in the selling prices as well as for Polyester. To some extent the price cuts had been announced, about Rs.4/- on an average per kilogram was reduced in the last 15 days are so. The industry is not willing to reduce prices, beyond this level, there would rather reduce stocks and wait it out and review the situation when the prices of raw materials stabilize

Ricky Kripalani: So at this point you are saying your PTA prices have come down from to say about USD1200 to USD800?

Vivek Kaul: No, PTA has come down by USD 100. They are sold at about USD 1,100 currently.

Ricky Kripalani: Right, and MEG?

Vivek Kaul: MEG has come down by USD 200.

Ricky Kripalani: Okay that's come down by USD 200. Are you are expecting the PTA prices to fall further?

Vivek Kaul: Yes, they will fall further I think. PTA manufactures are any case facing severe margin pressures they have been operating at a break cash situation. So they are tracking for any fall in PX prices, which will result in further falls in PTA prices.

Ricky Kripalani: And what about your imports from China? Is that still happening or has that been reduced?

Vivek Kaul: What, product or raw material?

Ricky Kripalani: No, of your finished products.

Vivek Kaul: There is no import of Polyester from China.

Ricky Kripalani: There is none at this point?

Vivek Kaul: There hasn't been any.

Ricky Kripalani: Okay so there is no imminent threat of any kind of cheap import from anywhere?

Vivek Kaul: From time-to-time some cheap products come into the market but in today's scenario that is not possible because this market expected to fall. Anybody who buys anything now will probably pay more than when he actually gets it.

Ricky Kripalani: That means with our medium-to-long term view on this industry at this point you are not expecting any kind of imminent threats of any sort from any kind of dumping or any kind of cheap imports from any destination?

Vivek Kaul: No, I don't think so. I think this adjustment which is taking place is good in the medium term to long term for the industry because it enables us to reduce the cost for our customers and become far more competitive when we look at cotton and it is only a bit of pain as you go through, because there has been a sharp adjustment. So, I think, it is the sooner the prices stabilize, at whatever level I think that will be the good for the industry from there on.

Ricky Kripalani: But when you say pain, how is there pain if you have enough inventories which are all basically going to shorten your pipe line and build up production at a later point when the raw material prices adjust? Do you see any pain, in the operating margins are concerned?

Vivek Kaul: Not really because most of the stock and the product that we are selling currently was manufactured either in the previous month or the month before that. The market has adjusted to those levels of prices, so we don't see much loss in that sense because, you should recall, prices have gone up very sharply in the last three months for our finished product.

Ricky Kripalani: Yes, from may be close to 30%.

Vivek Kaul: Yes close to 30% which was higher than the anticipated raw material prices or rather the raw material prices increase did not match with this. They were expected to match but then there after they cooled off so we in fact got the benefit in Q1 and to some extent there is a carry over of that benefit into July and now it will extend into August so it's a healthy correction because it is pointing in the right direction of lower prices.

Ricky Kripalani: Okay but I feel also the PSF Vis a Vis POY is more under pressure as far as demand is concerned?

Vivek Kaul: No I don't think so. Why do you say that?

Ricky Kripalani: No, is your PSF capacity fully utilized vis a vis POY capacity?

Vivek Kaul: Right now we are not operating the plant at full capacity.

Ricky Kripalani: No, I am talking about the last Quarter and the once preceding that? Isn't it that generally your PSF has a slower off take?

Vivek Kaul: PSF, yes on the general terms you could say right because PSF has excess supply because they are 3 manufacturers: Bombay Dyeing, Reliance and us and there is much larger over capacity in that sector.

Ricky Kripalani: And is it also due to the blending component of the cotton prices being high so overall demand is flattened generally in that space?

Vivek Kaul: Cotton prices being high it is good for us because the mill can use polyester rather than cotton to the extent they can and that shift has been taking place so the demand has been growing but there is excess capacity therefore pricing pressure and at times under production has been factors prevailing.

Ricky Kripalani: When do you see this over capacity being weaned out due to demand increase?

Vivek Kaul: This demand, including exports and considering that the industry exports 20,000 tons of PSF every month and the local demand is now around 60,000 so we are at say 80,000 tons of products. The industry can produce about 90,000 tons to 95,000 tons. I think another six months to one year we should have a balanced demand supply situation.

Ricky Kripalani: But are there no new expansions coming up in both this POY / PSF space?

Vivek Kaul: PSF nothing is coming up. POY there is some adjustment of some chip capacity moving down stream into POY. There were several other plans of various other producers in Gujarat but they have all been deferred now in view of last year's low margins.

Ricky Kripalani: So, essentially you feel that the demand supply will equilibrate within 3-6 months or you see a bit further delay?

Vivek Kaul: After 6 months to within one year for PSF and in POY on paper we are balanced as of now so there is not a question of demand-supply really.

Ricky Kripalani: Okay and due to higher cotton prices will there be some semblance of pricing power in your POY stock, in your finished good? Is that happening because right now because of the adjustment again one is not having clear visibility?

Vivek Kaul: Yes, it is happening because if you see when the prices went up in May and June? It was a clear demonstration that markets were accepting it and over the last 18 months I have never seen prices going up so fast and so smoothly in the market.

Ricky Kripalani: Have cotton price come off at all or they still right at the top?

Vivek Kaul: No they are still right at the top.

Ricky Kripalani: Because of that do you definitely see more traction on your finished products over time?

Vivek Kaul: Yes.

Moderator: Thank you Mr. Kripalani. The next question is from the line of Mr. Amol Rao from Pinc Associates. Please go ahead.

Amol Rao: I just wanted to know this M-to-M loss of Rs. 28.2 crore that we have incurred in this quarter - it's not a cash loss - but what is this for exactly?

Vivek Kaul: Re-evaluation of assets and liabilities outstanding on that date. We import raw material namely MEG so we have LCs which are outstanding so the liability has been revalued, and we have debtors for exports for which assets have been revalued and so have loans.

Amol Rao: According to AS30 we have not provided anything for the loss on according to AS30. What is the Rs. 12.72 crore that is mentioned in the release? Could we have some light on that?

Vivek Kaul: We have two derivative positions which we had taken about a year back in order to reduce our interest cost by borrowing in Swiss Francs and in Japanese Yen. So it is mark to market on that.

Amol Rao: When do we have to close these derivatives?

Vivek Kaul: We are going close in the next 10-15 days.

Moderator: Thank you Mr. Rao. We have two questions now. The first question is from the line of Mr. Ashish Saraf of NVS Brokerage. Please go ahead.

Ashish Saraf: First of all I wanted to know your current capacities and expansion plans?

Vivek Kaul: Current name plate capacity is about 1,600 tons per day and we have no expansions plans as of now.

Ashish Saraf: And in the power sector?

Vivek Kaul: Power sector we can produce 30 MW out of coal base power and about 48 MW out of the diesel generating sets.

Ashish Saraf: And second thing in your notes actually, you have shown that you are not provided treatment as per AS11, and you have shown you have adjusted the expenses in the carrying cost of fixed assets can you give some explanation regarding this?

Vivek Kaul: Yes you see we had borrowed in Euro and Dollars for the last expansion. So we had brought machinery from Europe against these foreign currency loans. So what we have done is that we have increased the value of the asset on the asset side matching with the increase in the loan outstanding in rupee terms. The loan is repayable over the next 5 to 7 years so the actual outcome of the loan will materialize over the period of the loan. As of now it was just an increase in the notional value so we have capitalized it and the asset and we charge depreciation on the revised value. In case the rupee appreciates in the future the value of the asset will come down and so will depreciation.

Ashish Saraf: Okay but I think there is some change in AS11 and schedule VI so is it that it should be expense out or still there is a need to capitalize.

Vivek Kaul: I will give you the background - AS11 is the standard released by the Institute of Charted Accountants, which has been notified also by the Government. In a way it is recommended to be used by the industry. AS11 says that any change, even notional changes in foreign exchange translation should be passed through the current years profit and loss account. However schedule VI is part of the Companies Act and states that any change in the foreign exchange value of a loan which is taken to finance fixed assets should be adjusted with the cost of the asset. Thus there are two different approaches suggested now and in our view and in the view of various legal experts, Schedule VI overrides anything else contained in any notification issued by the institute. This is because Schedule VI is part of the law. So a lot of industry participants are taking advantage of these two differing views and working either by AS11 or by schedule VI till such time as the Government clarifies and rectifies the position - basically to they have to either amend schedule VI or AS11.

Moderator: Thank you. The next question is from the line of Mr. Vikram Mago from JM Financial. Please go ahead.

Vikram Mago: Hi, this is for the clarification right now. Schedule VI is for the presentation of accounts side and AS11 is for the accounting aspect of it, so could you just clarify little on why that is disconnect between the two?

Vivek Kaul: Schedule VI if you read it correctly it also says that the loans have to be the value of the asset has to be based on the current outstanding value of the loan so there is a provision in schedule VI of adjusting the value of the balance on the balanced sheet date of the assets acquired out of foreign exchange loans.

Vikram Mago: So you have adjusted in the capital value of the assets. Correct?

Vivek Kaul: Yes.

Vikram Mago: Suppose if you take a one dollar of a loan and dollar value to dollar goes to say Rs.35/-. Can you value the asset goes to Rs.35/- instead of Rs.40/-?

Vivek Kaul: Right. AS11 says that you pass through this Rs.5/- in your example the Rs.5/- through your current periods profit and loss account. Without adjusting the fixed asset value so your asset remains at 40. The loan has become 35. Rs.5/- difference in this case again goes to the profit and loss account. In our view, this distorts the current period’s of profit and loss account. Especially when there is a sharp fluctuation in the foreign exchange values. For this Rs. 35/- is not stable in this Quarter. It is stable over the next 5-7 years. So we have to smoothen out this process and we have adjusted the value of the fixed asset to Rs. 35

and if we happen to pay say 10 cents out of that loan during the Quarter, we pay it at the current exchange rate and that impact will be felt in the Quarter under review.

Vikram Mago: Correct, but as for schedule VI this would be if the loan is specifically taken for the capital asset. So obviously if the rupee appreciates then automatically the value of the asset should come down. Right?

Vivek Kaul: Right.

Vikram Mago: Sir that's in normal understanding of schedule VI, right?

Vivek Kaul: Right.

Vikram Mago: And that's what you're following?

Vivek Kaul: That's what we are following but AS11 as notified by the Government is that you pass it through the profit and loss account.

Vikram Mago: If that obviously schedule VI talks about a loan taken for a capital asset so if any other loans taken would be passed to profit and loss because it was otherwise the cost will be capitalized. Right?

Vivek Kaul: That's the right way.

Vikram Mago: So that's the normal way?

Vivek Kaul: Yes, they are normal in the view that you can either follow AS11 for everything including loans taken for fixed asset or people like us who are not following that for loans taken for assets. We are passing through and we adjusting the value of the fixed assets, others are passing it through the profit and loss account.

Moderator: Thank you. The next question is from the line of Mr. Ricky Kripalani an Individual Investor. Please go ahead.

Ricky Kripalani: Yes, when is it likely for Indo Rama's capacity to be fully utilized and run at full capacity?

Vivek Kaul: I would expect the POY to be utilized in the next few months. It has been utilized fully from time-to-time in the last few months also. PSF may take between 6 months to one year to be fully utilized.

Ricky Kripalani: How does Indo Rama rate itself against international players just in terms of cost efficiency. I do understand that there are some costs which tend to be uneven in as much as say power and some other infrastructural cost but given the fact that you already merged your power division with yourself? How does it stand now?

Vivek Kaul: I think in the balance we are fairly competitive, we have disadvantage in terms of outward freight because we are some distance away from the market in India, so we incur some extra freight for getting our product to Gujarat markets. But we have advantage of cheaper power, we have fairly good handle on costs including labor and our plant is as modern as any other available in the country, especially the expansions so there we have economies of scale and by and large we would say we are better than any other player but to derive most of these benefits you must run the plant at full capacity.

Ricky Kripalani: Correct. So what about Reliance? Do they have any additional expansions on stream coming up or announced?

Vivek Kaul: To the best of our knowledge they don't have any Polyester expansion's planned out and incidentally Reliance also has various vintage plants. All the acquired units are of the mid 80's and all the plants at Patalganga are also in the early 90's and except for the new one they put up there. Similarly with Hazira they are from the early 90's till of 4-5 years they have put of several CPs at that time and they put up few more CPs in the last two years which is just as we did.

Ricky Kripalani: So you're saying essentially their efficiency level may not be substantially better or even better for that matter?

Vivek Kaul: In some cases worse off and in some cases as good.

Ricky Kripalani: Okay so there is nothing major in the pipeline from any major player in India at this point for capacity expansion?

Vivek Kaul: No there is nothing major. There is some expansion or as mentioned. JBF is putting up a separate CP, but half of it will be I believe PET grade polyester for export and half will be for textile grade chips, which they will use to convert into POY.

Ricky Kripalani: So pricing power is likely to come in a sustainable fashion, given that you said that imports are likely to be a non event over the foreseeable future.

Vivek Kaul: I think in the next few months you should see pricing power in POY definitely settling in. We don't want to jump to a conclusion that yes, from next month we will have pricing power but I think it is likely to happen sooner rather than later. In PSF will take a little bit of time because there is a 20000 tons of export also if you increase domestic prices sharply there is tendency of diverting the export into the domestic market so it will take a little bit of time in PSF may be 6 months and POY should be much sooner than that.

Ricky Kripalani: But my main focus of the question was sustainable not something that comes in for a month and then disappears again. Since capacity expansion typically takes at least 12-18 months. Do you see that coming up and being sustained over the next 12-18 months**?**

Vivek Kaul: Yes I do see that and I think next year all of these positive factors would have played out and this industry would be in a very good position to command much higher margin than they have seen in the recent past.

Moderator: Thank you Mr. Kripalani. We have another question from the line of Mr. Amol Rao from Pinc Research. Please go ahead.

Amol Rao: Yes sir I just had a question with regard to your power division. Sir our PBIT margin the division seems to have gone down tremendously almost 13% Y-O-Y? Sir could I get a sense of why this is happening sir I mean is this because of the furnace oil prices or?

Vivek Kaul: With what period are you comparing?

Amol Rao: Sir I am comparing with the corresponding period last year sir the segmental results I think Rs. 59 crore of sales this year compared to Rs. 31-32 crore last year and profit of PBIT of around Rs. 9 crore in each year so I was just wondering why the drop in the PBIT margin for the power division sir?

Vivek Kaul: Actually while we are given segment results I would like to just clarify that last year we have not restated the result for Q1 of last year. Therefore at that period of time for the segment comprised only of DG sets.

Amol Rao: If you have restated the power revenues then what would be. Any idea sir or should I come back to you with that later?

Vivek Kaul: We didn't have much of sale outside that period so most of it is basically internal sale.

Amol Rao: Yes but that would have netted off in inter-segment revenues. Right sir?

Vivek Kaul: Yes it would have, yes. There are some sales but small sales and also it will be difficult to compare period-to-period because the merger took place in December. So it is effective from 1st February, 2007. This segment has been treated to make it comparable with this result but the segment is strictly only DG set which is transferring power to the polyester division. And the CPP impact will come in later - in the third Quarter.

Amol Rao: Okay and could you tell me what kind of margins we are trying to target there?

Vivek Kaul: Yes I will have to look at numbers separately so you could write to me.

Amol Rao: Yes, yes sir I will do that. Thank you so much sir.

Vivek Kaul: Thank you Mr. Rao. The next question is from the line of Mr. Paras Nagda from Enam Holding. Please go ahead.

Paras Nagda: Yes sir, I just wanted to check out on the other income which seems to have gone up from Rs. 10.9 crore to Rs. 22 crore so can I get a break up for the other incomes?

Vivek Kaul: Yes, other income will now be more or less standard every Quarters. It's a good point you have brought up as I was meaning to highlight that myself. Other income this Quarter has about Rs. 15 crore of sales tax benefit. If you see our new expansion we have sales tax remission from Government of Maharashtra so whatever sales tax we collect from our customer, which is basically either CST or VAT that is refunded to us by the Government of Maharashtra. So we do not club it with the sales but it shows as other income so for the CP4 and CP5 we had a number of about Rs. 15 crore out of Rs. 22 crore.

Paras Nagda: Okay so basically now this will be….

Vivek Kaul: Every Quarter you will have Rs. 15 to 18 crore or so of this. And rest of the other income is normal sale of scrap, interest received, dividend, etc.

Moderator: Thank you. The next question is from the line of Mr. Ashish Dangi from Edelweiss Asset Management. Please go ahead.

Ashish Dangi: Sir could you tell the MEG prices and MEG outlook sir?

Vivek Kaul: MEG prices currently are last week USD 970 per ton. They were about USD 875 in March 2007 so and they were at USD 1,650 in December 2007. They had gone up very sharply in Q3 of last year because one of our suppliers had a production problem. That problem got sorted out in February and March and that same supplier is now coming out with two new capacities which will be on stream in I think in October and in December, which is equal to about almost 1.5 million tons of capacity. In anticipation of that and because the crude prices have come up, MEG has sharply declined as has most of the raw material, but may be sharper than PTA declined. So it is now approaching last March numbers and even if you see today between this period from March 2007 to July 2008, crude is up by 113% even after coming off. PTA is up by 26% and MEG is up by only 10% in this period.

Moderator: Thank you Mr. Dangi. I would now like to hand the conference over to the Management for their closing comments.

Vivek Kaul: Thank you I think we have covered most of our points and hopefully answered your queries and just one information I would want to leave you with is that while we do not have any expansion plan in terms of product, we are looking at converting our furnace oil fired heating system at the five CPs that we run at Butibori from furnace oil to coal. We have identified the supplier. We have identified the consultant and appointed him and engineering consultant. We should be starting the project in the next 15-20 days which is putting up coal fired heater along with all the piping and all the coal handling and ash disposal system. Total cost of this project is about 80-85 crore and it will give us a benefit of about 50 to 60 crore per year in terms of saving in cost of heating the plant as compared to FO in current prices of FO and current prices of coal and we expect that the prices differential between the two will remain and so it has a very strong payback period and that benefit will continue to flow to us in the years to come. I expect this to be commissioned sometime in July or so of next year and with that I would like to conclude this conference call. Thank you gentlemen and ladies for joining in. Thanks a lot.

Moderator: Thank you Mr. Kaul. Thank you Mr. Gurumoorthy and Mr. Desa. Ladies and gentlemen on behalf of Indo Rama Synthetics Limited that concludes this afternoon's conference call. Thank you for joining us and you may now disconnect your lines. Thank you.